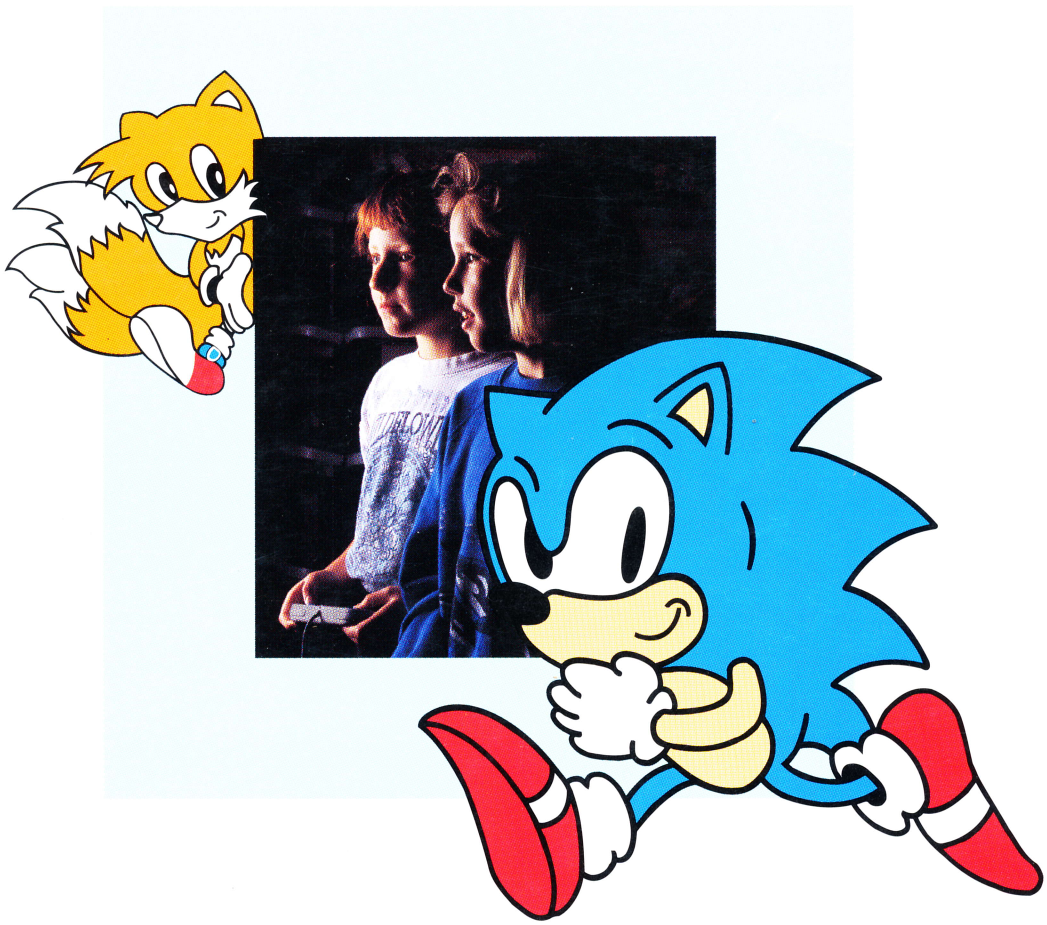
FuncoLand

YOUR SOURCE FOR INTERACTIVE ENTERTAINMENT

1993 ANNUAL REPORT



THE COMPANY

Funco, Inc., through its *FuncoLand* stores, is a leading specialty retailer of previously played interactive entertainment products. The Company purchases previously played video games, hardware and accessories and resells them to the public at an average of half the original retail price. Funco's product line includes a wide selection of Nintendo® and Sega® video games, hardware and accessories.

As of June 1993, the Company operated 66 retail locations in five metropolitan markets supported by a mail order business and *Game Informer*, a publication for video game enthusiasts with a paid circulation of 60,000.

Headquartered in Minneapolis, Minnesota, Funco, Inc., was incorporated in 1988 and has been a public company since August 1992.

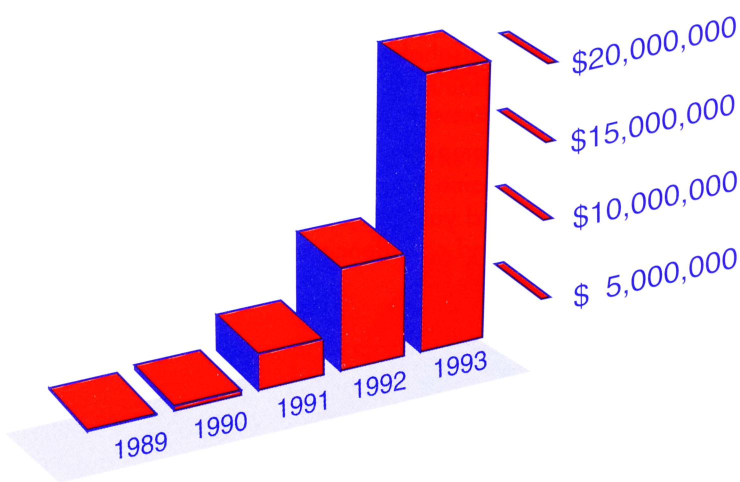
The Company's stock is listed on the NASDAQ market where it is traded under the symbol FNCO.

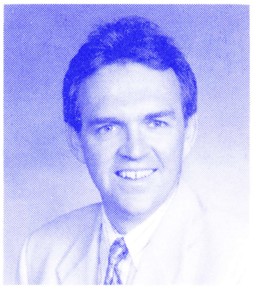
FINANCIAL HIGHLIGHTS

	Year Ended				
	April 2, 1989	April 1, 1990	March 31, 1991	April 5, 1992	April 4, 1993
	(unaudited)	(unaudited)			
Statement of Operations Data:					
Net sales	$ 38,842	$299,116	$2,518,985	$7,069,503	$20,533,944
Net income (loss) (1)	$ 6,622	$ 3,528	$ 84,579	$ 20,527	$ (519,779)
Net income (loss) per share	$ .00	$ .00	$ .02	$ .01	$ (.12)
Weighted average number of shares	3,392,241	3,392,241	3,392,241	3,403,777	4,164,247
Stores open at end of year	0	0	3	11	56
Balance Sheet Data:					
Total assets	$ 37,424	$137,667	$ 404,942	$1,974,808	$ 7,553,432
Long–term obligations	16,943	77,390	32,594	183,048	457,819
Shareholders' equity	6,722	10,250	94,829	202,180	4,483,873

(1) Prior to the Company's initial public offering in August 1992, the Company operated as an S corporation for tax purposes. In fiscal 1993, subsequent to the initial public offering, the Company operated as a C corporation; however, the Company's net loss resulted in no income tax expense for the Company. Had the Company been a C corporation from inception, the pro forma net income (loss) for the five fiscal years ended April 4, 1993 would have been $5,622, $2,528, $61,579, $15,527, and $(490,779), respectively. The pro forma net income per share for fiscal 1992 would have been $.00 with all other years' pro forma net income (loss) per share remaining unchanged from the net income (loss) per share amounts shown above.

NET SALES





Dear Shareholder:

Fiscal 1993 was a pivotal year for Funco, as it represented the first test of our retail concept on a national basis. It also proved to be the most exciting year in our short history. In twelve months we opened 45 new stores in three new markets, achieved revenues of more than $20.5 million, assembled a first-rate management team with the necessary retail experience to expand our concept nationwide, and in August 1992, we completed an initial public offering, raising $5 million in capital used to fuel our expansion. In short, we met our business and financial objectives for the year. Following are some additional highlights:

•We currently operate 66 stores in five markets. These include 11 stores in Minneapolis, 27 stores in Chicago, 14 stores in Dallas/Fort Worth, 5 stores in Milwaukee, and 9 stores in Detroit. In fiscal 1993, our store opening strategies were put to the test and proved efficient and effective.

•Our fiscal 1993 revenues of $20,533,944 reflect an increase of 190.5% over 1992 with 97% of these sales coming from our retail operations.

•Our *Game Informer* magazine, introduced in fiscal 1992, has a paid subscriber base of more than 60,000 (up from approximately 4,000 at the beginning of the year) and shows signs of soon becoming profitable.

We are very encouraged by the positive response our concept has received in diverse national markets, and are responding with continued rapid expansion. We continue to target major metropolitan areas and stage rapid rollouts of multiple stores in high-traffic strip malls. In fiscal 1994, we will establish an East Coast presence as we enter the suburban New York metropolitan market, with plans for approximately 30 stores in that market this year. Opening numerous stores simultaneously in one region gives us the advantages of a strong, preemptive market presence and allows us to achieve economies of scale in leasing, distribution and advertising expenditures.

To financially support this expansion, I am pleased to report that we have just completed a second public stock offering of 1,302,500 shares. Estimated proceeds of $13.1 million will be used to develop additional retail stores, to expand the Company's management information systems and for general corporate purposes.

At this point, the video game industry shows little sign of slowing. Nintendo and Sega reported sales of $5 billion in 1992, and 38% of all US households now own video game systems – statistics that attest both to the scope of the interactive home entertainment industry and its sustained popularity and potential.

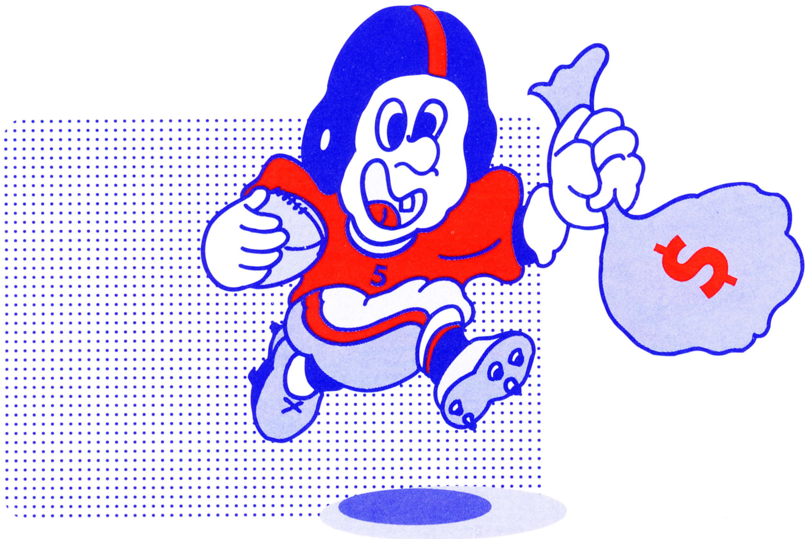
We at Funco firmly believe that our Company is well positioned to remain the dominant and preferred provider of previously played interactive home entertainment. By continuing to meet our business and financial objectives, we intend to justify and reward your support of our Company. On behalf of our employees and our Board, I thank you for your interest and confidence.

Sincerely,

David R. Pomije

David R. Pomije
President and CEO

June 23, 1993



Product Buyback

Customers can sell games or equipment to FuncoLand and receive either a check or store credit. Stores acquire most of their inventory through this popular buyback policy.

THE RIGHT INDUSTRY: THE RIGHT IDEA

The *FuncoLand* concept is relatively simple: To purchase previously played video games and equipment from the public and resell them at a profit. It is similar to a commodities business, a game of supply and demand. But there are several factors that differentiate this product and industry from others -- and make it particularly lucrative and appealing.

Video games are durable:

Unlike videotapes or cassettes, video games have no moving parts and, consequently, do not wear out. A previously played game is literally as good as new.

The industry churns products:

Each year, manufacturers of video games release hundreds of new titles while they cease production of hundreds of others. It's all part of the ongoing quest to generate excitement and sales. The limited availability of many popular games fuels demand in the secondary, resale market.

A growth industry that's sweeping the nation:

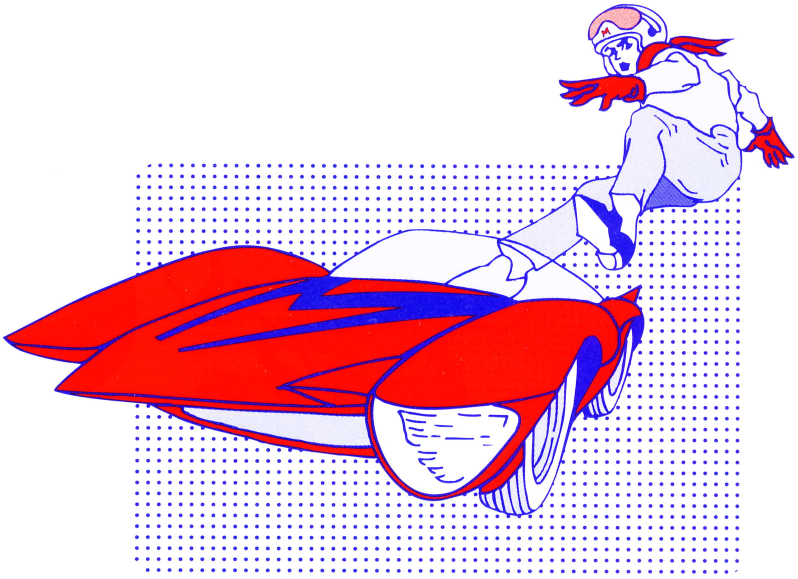
Today, 75 million people regularly play video games, and more than one-third of all US households have a video game system installed. Since 1985, more than 350 million game cartridges have been sold.

THE SECRET TO FUNCO'S SUCCESS

In addition to being a major player in an industry that's loaded with potential, there are key factors that make Funco, in particular, a successful retailer of these products. These four components differentiate the Company and add up to value for its customers:

In-Store Trial

At FuncoLand, customers are encouraged to try out any game – new or previously played – before buying it. This free-trial policy maximizes customer satisfaction and minimizes product returns.



Superior selection:

Each *FuncoLand* store offers approximately 1,500 different titles compared to about 500 new titles at other specialty retailers.

In-store trial:

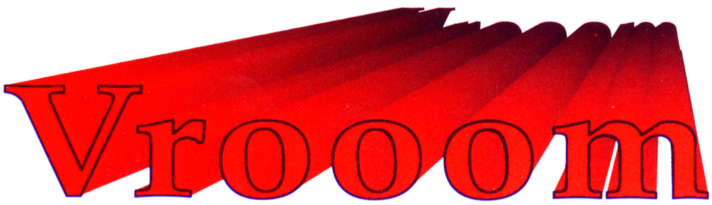
Customers can try any game – new or previously played – before they buy it.

Low prices:

FuncoLand sells previously played games for an average of half their original retail price.

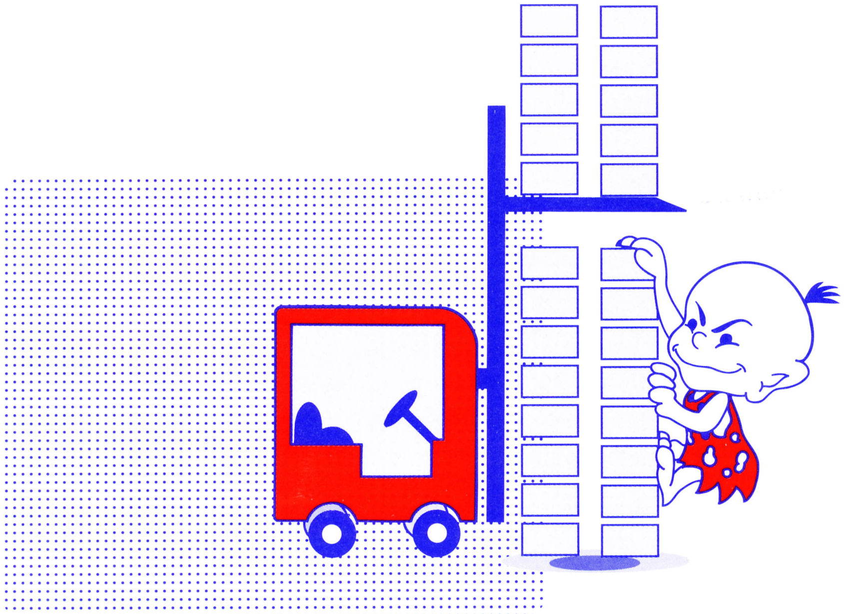
Product buyback:

FuncoLand purchases games and hardware from customers and offers them a check or store credit. 75% of customers opt for credit and put their money back into the store.



OVERCOMING THE COMPETITION: BE FIRST, FAST, BIGGER AND BETTER

While Funco isn't the only purveyor of used video games, it has the advantage of being the leader. At this point, the competition is primarily limited to independent shops and smaller regional chains with significantly less capital and inventory. Further, it would be a considerable challenge for a newcomer – even a major retailer – to learn to evaluate previously played inventory and develop the systems necessary to manage it. Funco has a head start: By penetrating major metropolitan markets before any serious competition arrives, the Company intends to both dissuade competitors and to establish a preferred relationship with customers. Further, the *FuncoLand* concept revolves around selection, service and pricing that really can't be beat.



Superior Selection

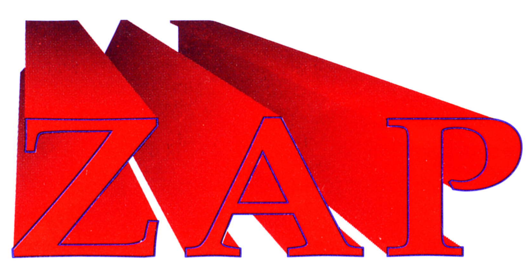
Other specialty retailers stock approximately 500 video game titles – all new and current. By comparison, each FuncoLand store offers around 1,500 different titles, including hundreds that are no longer manufactured.

FUNCO'S RETAIL STRATEGY AND ADVANTAGE

FuncoLand stores average 1,600 square feet and are located in high-traffic strip shopping centers in major metropolitan markets. While most of their inventory is supplied by customers, the stores can also rely on the Company's central supply and mail order operation for specific titles or inventory backup. Products are priced using a sophisticated bid/ask pricing model based on supply and demand that is updated twice a month by corporate management. Management information systems provide daily sales figures, margins and inventory by item for all stores. At a typical store, 72% of net sales are video games, primarily previously played. Hardware and accessories, both previously played and new, supply the rest of revenues. At each *FuncoLand* store, service is key. Employees are trained to give advice and to encourage the trial of products. All products are sold with a 90-day warranty.

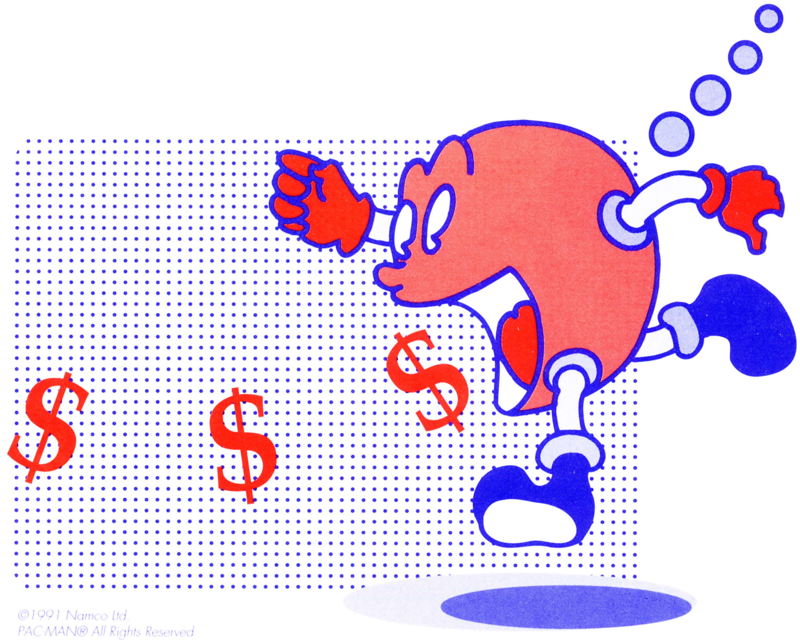
NINTENDO AND SEGA: THE GAMES PEOPLE PLAY

It all started with a game called Pong. Suddenly Americans discovered that their television sets were not just objects of passive viewing but could actually be instruments for interactive play. Twenty years later, the home entertainment industry has grown into an international powerhouse dominated by two key players: Nintendo and Sega. As technology has changed, from 8-bit to 16-bit to CD-ROM formats, programs have become more elaborate and challenging, and the audience for video games has expanded. They're not just for kids anymore.



Low Prices

By focusing on previously played video products, *FuncoLand* can sell games at approximately half the original retail price. Lower prices allow consumers to buy more games.



Of the 75 million people who regularly play video games, 45% are older than 18. In the giant home entertainment market, Funco is an essential link. *FuncoLand* stores give the public a formalized way to trade and recirculate the huge existing base of games.

FUNCO'S BEGINNINGS: HUMBLE, BUT AUSPICIOUS

In 1988, Funco's founder and president, David Pomije, discovered this million dollar concept: There was a vast and then untapped market for used video games. With an initial supply of 1,100 Nintendo games, he started by renting them to video stores, and then began selling them via mail order from his home. The response was instant and overwhelming. In three short years, Funco has grown from a mail order operation with one retail store into a 66-store chain in five metropolitan markets.

FUNCO'S FUTURE: PLAYING TO WIN

This rapid growth is both an indication of the momentum of the interactive home entertainment industry and a testament to the success of Funco's unique niche and formula. The future for Funco holds more of the same: expansion in major metropolitan markets, rapid rollout of multiple stores in high-traffic strip malls, aggressive TV advertising and marketing support, and further refinement and investment in sophisticated inventory control and management information systems.

Though *FuncoLand*'s product is fun and games, the business of selling them isn't. In the interactive home entertainment market, Funco is playing to win.

POW

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

The Company has grown from three retail stores at the end of fiscal 1991 to 56 at the end of fiscal 1993. In fiscal 1993, the Company opened its first stores outside the Minneapolis-St. Paul area. It opened its first store in Dallas in April 1992, in Chicago in July 1992, in Milwaukee in January 1993 and in Detroit in April 1993. The Company intends to enter the suburban New York metropolitan market during the first quarter of fiscal 1994.

The Company's business is seasonal in that the majority of its annual net sales is generated during the third and fourth fiscal quarters. As a result of this seasonality and the fact that the Company expects to incur substantial expenses in connection with its planned store expansion, the Company anticipates significant losses in each of the first two quarters of fiscal 1994. Profitability in the last two quarters of fiscal 1994 will depend on performance of existing stores and attainment of projected performance by new stores.

In addition to seasonality, key factors affecting net sales and profitability include the number of stores in operation and their relative maturities, new store openings, location of stores and customer demographics, merchandise selection, competition and acceptance of current marketing techniques. Management believes that most new stores will attain mature store sales levels within six months after commencing operations and thereafter will experience only modest sales growth. No assurance can be given, however, that new stores will achieve, or that current stores will sustain, desired operating results and profitability.

Results of Operations

The following table sets forth certain items in the statements of operations expressed as (i) percentages of net sales for the years indicated and (ii) percentage changes from the prior year:

	Fiscal Year			Percentage Increase (Decrease)	
	1991	1992	1993	1992 over 1991	1993 over 1992
Net sales	100.0%	100.0%	100.0%	180.6%	190.5%
Cost of sales	53.5	52.7	57.2	176.7	215.1
Gross profit	46.5	47.3	42.8	185.2	163.0
Retail operating expenses	26.4	26.1	27.3	178.2	203.4
General and administrative expenses	16.5	20.7	17.8	252.5	149.1
Operating income (loss)	3.6	0.5	(2.3)	(67.8)	–
Interest expense, net	0.3	0.1	0.3	17.9	503.9
Net income (loss)	3.3%	0.4%	(2.6)%	(75.7)	–

Comparison of Fiscal 1993 to Fiscal 1992

Funco derived approximately 97% of its fiscal 1993 net sales from its retail operations. The balance of net sales was attributable to publication of *Game Informer* magazine. Net sales increased from $7,069,503 in fiscal 1992 to $20,533,944 during fiscal 1993, an increase of 190.5%. The growth in net sales occurred primarily as a result of new store openings, with net sales of new stores accounting for approximately $13,000,000 of fiscal 1993 net sales. The Company operated 56 stores at the end of fiscal 1993 compared to eleven stores at the end of fiscal 1992. The Company expects net sales to continue to increase in fiscal 1994 as a result of new store openings.

Cost of sales increased from $3,726,514 in fiscal 1992 to $11,741,345 during fiscal 1993, a 215.1% increase. This increase was primarily attributable to higher net sales levels resulting from the increase in the number of stores. Cost of sales as a percentage of net sales increased from 52.7% to 57.2%. Contributing to this increase was a change in the Company's sales mix, with a higher proportion of fiscal 1993 net sales generated from new hardware systems. These products generally have both a higher cost and a higher selling price but generate lower gross margins than previously played merchandise. The Company does not expect any additional significant change in the percentage of new product sales in fiscal 1994. Also, the costs of publishing *Game Informer* magazine increased at a faster rate than the growth of magazine revenues. In addition, the Company followed a more aggressive purchase pricing strategy for previously played games than in the prior year to ensure adequate inventory levels for the expanding base of stores. Favorably impacting cost of goods as a percentage of net sales was the allocation of costs associated with the Company's distribution center over the larger net sales base.

Retail operating expenses increased from $1,847,422 in fiscal 1992 to $5,605,220 in fiscal 1993, a 203.4% increase. This increase was primarily attributable to an increase in the number of stores. Retail operating expenses as a percentage of net sales increased from 26.1% to 27.3%, reflecting preopening and start-up expenses for new stores, including recruitment, travel, training and advertising. The Company increased its store base by 45 locations in fiscal 1993 as compared to an increase of eight locations in fiscal 1992.

General and administrative expenses increased from $1,465,846 in fiscal 1992 to $3,651,636 in fiscal 1993, or 149.1%, but decreased as a percentage of net sales from 20.7% to 17.8%. The dollar increase in general and administrative expenses was primarily attributable to the further staffing and development of corporate functions necessary to support the expanding retail operations. The decrease in general and administrative expenses as a percentage of net sales reflects leveraging resulting from the expanding store base. This trend is expected to continue in the future.

The Company incurred an operating loss of $464,257 in fiscal 1993 as compared to operating income of $29,721 in fiscal 1992. The Company's retail operations generated operating income of $98,544 in fiscal 1993 compared to operating income of $142,277 in fiscal 1992. *Game Informer* magazine incurred an operating loss of $562,801 in fiscal 1993 compared to an operating loss of $112,556 in fiscal 1992, primarily as a result of publishing six

issues of the magazine in fiscal 1993 compared to two issues in fiscal 1992. Management anticipates that, based on the current levels of paid subscriptions and advertising revenues, *Game Informer* operations will experience a significantly lower operating loss in the first half of fiscal 1994 than in the first half of fiscal 1993. If the current rate of adding subscribers continues, *Game Informer* operations are anticipated to be profitable in the second half of fiscal 1994.

Net interest expense increased from $9,194 in fiscal 1992 to $55,522 in fiscal 1993, primarily reflecting interest on increased average borrowings and capital lease obligations. As a result of its operating losses, the Company had no income tax expense in fiscal 1993. See Note 7 of Notes to Financial Statements.

As a result of the above factors, the Company incurred a net loss of $519,779 for fiscal 1993 as compared to net income of $20,527 in fiscal 1992.

Comparison of Fiscal 1992 to Fiscal 1991

Net sales increased from $2,518,985 in fiscal 1991 to $7,069,503 in fiscal 1992, a 180.6% increase. The growth in net sales occurred primarily as a result of new store openings. As the Company began fiscal 1991, it generated retail sales largely through mail order, with store operations commencing in the second quarter of fiscal 1991. Magazine publication commenced in the second quarter of fiscal 1992. The Company operated eleven stores at fiscal year end 1992 compared to three stores at fiscal year end 1991.

Cost of sales increased from $1,346,691 in fiscal 1991 to $3,726,514 in fiscal 1992, or 176.7%. This increase was primarily attributable to higher net sales levels resulting from the increase in the number of stores. Cost of sales as a percentage of net sales decreased from 53.5% to 52.7%. This decrease resulted primarily from allocation of distribution center expenses over a larger net sales base.

Retail operating expenses increased from $664,121 in fiscal 1991 to $1,847,422 in fiscal 1992, a 178.2% increase. This increase was primarily attributable to an increase in the number of stores. Retail operating expenses as a percentage of net sales decreased from 26.4% to 26.1%. This decrease reflects both the maturing store base and allocation of advertising expenses over a larger net sales base within the Minneapolis-St. Paul market.

General and administrative expenses increased from $415,799 in fiscal 1991 to $1,465,846 in fiscal 1992, or 252.5%, and increased as a percentage of net sales from 16.5% to 20.7%. This increase occurred as the Company hired an experienced senior management team, relocated its corporate headquarters and distribution center to larger facilities and began the development of the corporate structure required to execute the Company's store expansion plans.

Operating income decreased from $92,374 in fiscal 1991 to $29,721 in fiscal 1992. In fiscal 1992 the Company's retail operations produced operating income of $142,277 as compared with $92,374 in fiscal 1991. The 1992 retail operating income was partially offset by operating losses of $112,556 attributable to start-up expenses for *Game Informer* magazine.

Net interest expense increased from $7,795 in fiscal 1991 to $9,194 in fiscal 1992, a 17.9% increase, resulting from higher average borrowings.

As a result of the above factors, the Company generated net income of $20,527 for fiscal 1992, as compared to net income of $84,579 in fiscal 1991.

Seasonality and Quarterly Results

The Company's business is seasonal in that a majority of net sales is generated in the third and fourth quarters, which include the holiday selling season. For the ten stores operating the full 12 months in fiscal 1993, 37% of net sales occurred in the first half and 63% in the second half. Accordingly, annual profitability is heavily dependent on third and fourth fiscal quarter net sales. In addition to sales seasonality, the Company's quarterly results are also affected by the number and timing of new store openings. The Company's rapid growth may obscure the impact of seasonal influences. Because of the seasonality of the Company's business, results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year.

Net sales, gross profit and operating income (loss) for the past eight fiscal quarters, together with the number of stores open at the end of each quarter, are presented in the following table:

	Fiscal 1992				**Fiscal 1993**			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net sales	$721,254	$1,342,190	$2,800,416	$2,205,643	$1,495,831	$2,879,137	$8,911,568	$7,247,408
Gross profit	343,149	676,003	1,326,666	997,171	580,135	1,055,741	3,861,660	3,295,063
Operating income (loss)	7,734	(12,573)	133,061	(98,501)	(632,648)	(744,630)	719,838	193,183
Stores open at end of quarter	4	10	10	11	20	29	49	56

Although the results presented above may not be indicative of future trends or performance, the Company anticipates that quarterly net sales and operating income will continue to be significantly impacted by seasonality patterns.

Liquidity and Capital Resources

The Company's primary ongoing financing requirements are for new store expansion, inventory and management information systems. Prior to its initial public offering in August 1992, the Company relied on borrowings from banks, related parties and private investors, internally generated funds and trade credit to meet its financing needs. During fiscal 1991, 1992, and 1993, the Company had net cash provided by (used in) operating activities of $261,354, $298,831, and $(875,594), respectively. Cash used in operating activities in fiscal 1993 resulted primarily from the net loss of $519,779 and an increase in the level of inventory. The Company received net proceeds of $4,855,000 from its initial public offering, of which $1,588,000 was used to repay debt to banks and private investors and $3,267,000 was used for operations, capital expenditures and working capital.

The Company has a $1,000,000 revolving credit facility with a commercial bank. The interest rate on outstanding borrowings under the facility (7% at April 4, 1993) will be equal to the bank's reference rate plus one percent. Borrowings under the facility are collateralized by all of the accounts receivable, inventory and general intangibles of the Company. The Company may obtain advances totaling up to $500,000, subject to eligible inventory, and may obtain advances in excess of $500,000 to the extent they are secured by cash or certificates of deposit issued by the bank. In addition, the facility requires the Company to maintain certain financial ratios and achieve certain operating results.

During fiscal 1994, the Company plans to spend approximately $4,320,000 to open 54 new stores (seven of which were open at June 1,1993). The average cost to open a new store in fiscal 1994 is estimated at $80,000, including equipment and leasehold improvements and other capital expenditures totaling approximately $53,000 and inventory and preopening expenses totaling approximately $27,000. The Company also plans significant enhancements to its management information systems, the cost of which is currently estimated to be $1,400,000 to $1,700,000. Other capital expenditures during fiscal 1994, including remodeling of some existing stores, will be approximately $300,000. The Company intends to use the proceeds from a second public offering completed in June 1993 to finance a substantial portion of the above capital expenditures. The Company anticipates that a portion of its equipment acquisitions will be financed through leasing.

The Company believes that the net proceeds from the second offering, cash from operations and funds available under its revolving credit facility, will provide sufficient funds for financing planned store openings, working capital needs and other capital expenditures for at least 12 months.

Other Matters

The Company does not believe that its business has been significantly impacted by inflation.

The Company adopted Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" at the time of its initial public offering. The adoption of this Statement did not have a material impact on the financial statements.

REPORT OF INDEPENDENT AUDITORS

Board of Directors and Shareholders
Funco, Inc.
Eden Prairie, Minnesota

We have audited the accompanying balance sheets of Funco, Inc. as of April 5, 1992 and April 4, 1993, and the related statements of operations, shareholders' equity and cash flows for each of the three years in the period ended April 4, 1993. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Funco, Inc. at April 5, 1992 and April 4, 1993, and the results of its operations and its cash flows for each of the three years in the period ended April 4, 1993, in conformity with generally accepted accounting principles.

Minneapolis, Minnesota
May 28, 1993

Ernst + Young

FUNCO, INC.
BALANCE SHEETS

	April 5, 1992	April 4, 1993
ASSETS		
Current assets:		
Cash and cash equivalents	$ 231,700	$1,901,875
Accounts receivable:		
Trade, less allowance for doubtful accounts of $12,500 in 1993	63,624	130,482
Other	–	178,275
	63,624	308,757
Inventories	926,659	2,377,230
Prepaid expenses	72,760	420,862
Total current assets	1,294,743	5,008,724
Property and equipment:		
Furniture and fixtures	238,528	891,551
Equipment	314,837	1,272,946
Vehicles	64,143	64,143
Leasehold improvements	97,909	718,158
	715,417	2,946,798
Less accumulated depreciation and amortization	(122,870)	(520,891)
	592,547	2,425,907
Other assets, net of accumulated amortization of $19,073–1992 and $67,282–1993	87,518	118,801
Total assets	$1,974,808	$7,553,432
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 865,989	$1,169,783
Bank overdrafts	251,454	–
Notes payable to bank	150,000	–
Accrued liabilities:		
Purchase credit memos payable	31,328	274,439
Employee compensation and related taxes	69,499	326,826
Sales tax payable	30,445	135,892
Accrued rent	29,574	111,492
Other accrued liabilities	38,525	134,622
Current portion of long-term debt and capital lease obligations	73,623	191,507
Deferred revenue	49,143	267,179
Total current liabilities	1,589,580	2,611,740
Long-term debt	7,494	4,016
Capital lease obligations	175,554	287,307
Accrued rent	–	166,496
Shareholders' equity:		
Preferred stock, $.01 par value: Authorized shares – 1,000,000	–	–
Common stock, $.01 par value: Authorized shares – 14,000,000		
Issued and outstanding shares – 3,225,804 in 1992 and 4,375,804 in 1993	32,258	43,758
Additional paid-in capital	167,842	4,040,578
Retained earnings	2,080	399,537
Total shareholders' equity	202,180	4,483,873
Total liabilities and shareholders' equity	$1,974,808	$7,553,432

See accompanying notes.

FUNCO, INC.
STATEMENTS OF OPERATIONS

	Year ended		
	March 31, 1991	April 5, 1992	April 4, 1993
Net sales	$2,518,985	$7,069,503	$20,533,944
Cost of sales	1,346,691	3,726,514	11,741,345
Gross profit	1,172,294	3,342,989	8,792,599
Retail operating expenses	664,121	1,847,422	5,605,220
General and administrative expenses	415,799	1,465,846	3,651,636
Operating income (loss)	92,374	29,721	(464,257)
Interest expense	(12,128)	(16,665)	(91,508)
Interest income	4,333	7,471	35,986
Net income (loss)	$ 84,579	$ 20,527	$ (519,779)
Net income (loss) per share	$ .02	$ .01	$ (.12)
Unaudited pro forma information:			
Net income (loss)	$ 61,579	$ 15,527	$ (490,779)
Net income (loss) per share	$ .02	$ –	$ (.12)
Weighted average number of shares	3,392,241	3,403,777	4,164,247

See accompanying notes.

FUNCO, INC.
STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock		Additional Paid-In	Retained	Total Share-holders'
	Shares	Amount	Capital	Earnings	Equity
Balance at April 1, 1990 (unaudited)	3,000,000	$ 100	$ –	$ 10,150	$ 10,250
Net income				84,579	84,579
Balance at March 31, 1991	3,000,000	100	–	94,729	94,829
Common stock issued	225,804	2,258	197,742		200,000
Transfer to adjust common stock to authorized par value as a result of recapitalization		29,900	(29,900)		–
Distributions to shareholders				(113,176)	(113,176)
Net income				20,527	20,527
Balance at April 5, 1992	3,225,804	32,258	167,842	2,080	202,180
Common stock issued, net of costs	1,150,000	11,500	4,843,736		4,855,236
Distributions to shareholders				(53,764)	(53,764)
Recapitalization resulting from termination of S corporation status			(971,000)	971,000	–
Net loss				(519,779)	(519,779)
Balance at April 4, 1993	4,375,804	$43,758	$4,040,578	$399,537	$4,483,873

See accompanying notes.

FUNCO, INC.
STATEMENTS OF CASH FLOWS

	Year ended		
	March 31, 1991	April 5, 1992	April 4, 1993
Operating activities			
Net income (loss)	$ 84,579	$ 20,527	$ (519,779)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	23,979	108,983	467,219
Changes in operating assets and liabilities:			
Accounts receivable	(11,031)	(50,749)	(245,133)
Inventories	(27,152)	(832,121)	(1,450,571)
Prepaid expenses	(6,456)	(66,304)	(348,102)
Accounts payable	87,259	742,491	303,794
Bank overdrafts	36,320	215,134	(251,454)
Accrued liabilities	73,856	111,727	950,396
Deferred revenue	–	49,143	218,036
Net cash provided by (used in) operating activities	261,354	298,831	(875,594)
Investing activities			
Additions to property and equipment	(121,798)	(505,703)	(1,981,628)
Note receivable from related party	(76,172)	–	–
Increase in other assets	(11,387)	(94,946)	(100,481)
Repayment of note receivable from related party	–	78,933	–
Net cash used in investing activities	(209,357)	(521,716)	(2,082,109)
Financing activities			
Proceeds from issuance of long-term debt	35,543	–	–
Payments of long-term debt	(16,842)	(52,190)	(3,071)
Proceeds from line of credit with bank	25,020	250,000	450,000
Payments against borrowings on line of credit	(58,460)	(100,000)	(600,000)
Proceeds from note with officer	–	100,000	–
Proceeds from interim financing obligations	–	–	1,060,000
Payments of interim financing obligations	–	–	(1,060,000)
Proceeds from sale/leaseback of equipment	–	233,990	125,675
Payments of obligations under capital leases	–	(11,085)	(146,198)
Net proceeds from issuance of common stock	–	100,000	4,855,236
Distributions to shareholders	–	(113,176)	(53,764)
Net cash provided by (used in) financing activities	(14,739)	407,539	4,627,878
Increase in cash and cash equivalents	37,258	184,654	1,670,175
Cash and cash equivalents at beginning of year	9,788	47,046	231,700
Cash and cash equivalents at end of year	$ 47,046	$231,700	$1,901,875

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS
April 4, 1993

1. Significant Accounting Policies

Nature of Business – Funco, Inc. is engaged in the business of providing interactive home entertainment primarily through the purchase and resale of previously played video games and related hardware and accessory items through its *FuncoLand* stores and mail order operation. It also publishes a video game magazine, *Game Informer*. The Company was incorporated in Minnesota in March 1988.

Fiscal Year – The Company's fiscal year ends on a Sunday on or near March 31 which completes a 52 or 53 week reporting period. Unless otherwise stated, references to years in this report relate to fiscal years rather than to calendar years.

Fiscal Year	Ended	Weeks
1991	March 31, 1991	52
1992	April 5, 1992	53
1993	April 4, 1993	52

Cash Equivalents – Cash equivalents represent short-term investments with a maturity of three months or less at the time of purchase. Short-term investments are recorded at cost which approximates market.

Inventories – Inventories consist of new and previously-played video games, decks and accessories and are valued at the lower of cost, determined using the first-in, first-out (FIFO) method, or market.

Property and Equipment – Property and equipment are recorded at cost. The Company uses the straight-line method of computing depreciation based on the assets' estimated useful lives.

Other Assets – Included in other assets are deposits on leases as well as certain organizational and store pre-opening costs and other intangible assets which the Company has capitalized and is amortizing over periods ranging from one to five years.

Deferred Revenue – Deferred revenue represents amounts received for subscriptions to a specified number of future video game magazine issues. Revenue is recognized on a straight-line basis as the magazine issues are delivered.

Income Taxes – Prior to the August 12, 1992 initial public offering, the Company was incorporated as an S corporation under the Internal Revenue Code. Net income (loss) of the Company was reflected in the taxable income of the individual shareholders and no income tax expense was reflected in the Company's statements of operations for prior periods.

Effective with the initial public offering of the Company's common stock, the Company's shareholders were required to revoke the S corporation election and change to C corporation status. At that time, the Company adopted Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." The adoption of this Statement did not have a material impact on the financial statements.

Per Share Data – Net income (loss) per share is computed using the weighted average number of shares of common stock and common stock equivalents outstanding during the periods presented after giving effect to the application of Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 64. Pursuant to SAB No. 64, common stock issued by the Company at prices less than the initial offering price during the twelve months immediately preceding the initial public offering, plus the common stock equivalent shares granted at exercise prices less than the initial public offering price during the same period, have been included in the calculation of shares used in the calculation of net income (loss) per share as if they were outstanding for all periods.

Reclassifications – Certain items in 1991 and 1992 have been reclassified to conform with the 1993 presentation.

2. Note Receivable - Related Party

At March 31, 1991, a note receivable of $78,933 was outstanding from the chief executive officer/majority shareholder of the Company. The note had an interest rate of 9% and was paid in full during 1992.

3. Financing Arrangements

Subsequent to April 4, 1993, the Company has arranged for a $1,000,000 revolving credit facility with a bank. The interest rate on outstanding borrowings under the facility (7% at April 4, 1993) is equal to the bank's reference rate plus one percent. The facility is collateralized by all of the accounts receivable, inventory and general intangibles of the Company. The Company may obtain advances totaling up to $500,000 subject to eligible inventory and may obtain advances in excess of $500,000 to the extent they are secured by cash or certificates of deposit issued by the bank. In addition, the facility requires the Company to maintain certain financial ratios and achieve certain operating results.

4. Leases

Capital Leases – The Company has leased equipment under sale/leaseback and lease financing arrangements. Under the Company's sale/leaseback transactions, equipment was sold at net book value with no gain or loss recorded. The equipment capitalized under these arrangements and included in property and equipment is as follows:

	1992	1993
Equipment	$257,295	$632,723
Accumulated amortization	(31,717)	(142,110)
	$225,578	$490,613

Amortization of leased assets is included in depreciation and amortization expense.

Equipment at a cost of $23,305 in 1992 and $249,753 in 1993 was acquired in exchange for obligations under capital leases. Future minimum payments required under capital leases consist of the following for the years ending after 1993:

1994	$228,449
1995	238,707
1996	71,179
	538,335
Less amounts representing interest	(62,895)
Present value of future minimum lease payments	$475,440

Total interest paid, including interest on short-term borrowings and capital leases, was $11,694, $16,749 and $91,858 for the years 1991, 1992 and 1993, respectively.

Operating Leases – The Company has rental commitments for office and retail space and office equipment under non-cancelable operating leases. Certain of these leases contain provisions for renewal options and most require the Company to pay other lease related costs.

Future minimum lease payments under non-cancelable operating leases consist of the following for the years ending after 1993:

1994	$1,315,971
1995	1,351,546
1996	1,043,829
1997	311,756
1998	50,917
1999	18,667
	$4,092,686

Rent expense was $23,919, $199,643 and $689,578 for the years 1991, 1992 and 1993, respectively.

5. Shareholders' Equity

In May 1992, Board of Director action which was approved by the shareholders resulted in a recapitalization of the Company, authorizing 1,000,000 shares of preferred stock and 14,000,000 shares of common stock, both with a par value of $.01 per share. No preferred stock has been issued.

In March 1992, an officer of the Company exercised an option pursuant to an option agreement to purchase 112,902 shares of the Company's common stock. A $100,000 promissory note due the officer was exchanged as consideration for the option exercise.

On August 12, 1992 the Company completed the sale of 1,000,000 shares of its common stock to the public at a price of $5.00 per share. On September 14, 1992 the Company's underwriter purchased 150,000 shares of common stock from the Company, also at a price of $5.00 per share, pursuant to the exercise of the underwriter's over-allotment option. Of the combined net proceeds totaling $4,855,000, the Company used $1,588,000 to retire interim financing, along with bank financing and related accrued interest. Remaining proceeds of $3,267,000 were used for the funding of operations, capital expenditures and working capital.

6. Stock Options and Warrants

The Company's 1992 Employee Incentive Stock Option Plan provides for the issuance of 750,000 shares of common stock at prices at least equal to the fair market value of the common stock on the date of grant. Options granted under this Plan expire within ten years from the date of grant and become exercisable in five annual installments increasing from 10% in the first year to 30% in the fifth year, commencing one year from the date of grant. During 1993 the Company adopted a Stock Option Plan for Nonemployee Directors pursuant to which options for 100,000 shares of common stock may be granted at prices at least equal to the fair market value of the common stock on the date of grant. Options granted under the nonemployee director plan expire within five to seven years from the date of grant and become exercisable in one to two years from the date of grant.

A summary of stock option transactions is as follows:

	Shares		Price Per
	Reserved	Outstanding	Share
Balance at March 31, 1991	–	–	
Reserved	750,000	–	
Granted	(281,250)	281,250	$1.33
Balance at April 5, 1992	468,750	281,250	
Reserved	100,000	–	
Granted	(140,250)	140,250	5.00 - 6.66
Cancelled	5,250	(5,250)	6.66
Balance at April 4, 1993	433,750	416,250	1.33 - 6.66

Options to purchase 28,125 shares are exercisable at April 4, 1993.

Pursuant to the initial public offering of the Company's stock, a warrant to purchase 100,000 shares of its common stock at $6.00 per share was issued to the underwriter of the offering. This warrant extends for a period of four years, commencing August 12, 1993. As part of a private placement of promissory notes in May 1992, the Company issued warrants to purchase 30,000 shares of its common stock at $5.00 per share to several investors. The warrants are exercisable for a period of four years, commencing in May 1993. In April 1993, the Company granted to a consultant a five year warrant to purchase 7,500 shares of common stock at $12.75 per share. The warrant becomes exercisable in 1,000 share increments each month, commencing June 1993, with a final increment of 500 shares. In conjunction with the issuance of these warrants, the Company reserved 137,500 shares of common stock.

7. Income Taxes

As a result of its initial public offering on August 12, 1992, the Company terminated its S corporation status. At that time, the retained earnings deficit from inception to the date of revocation of $971,000 was reclassified from retained earnings to additional paid-in capital. The Company is subject to income taxes on income earned subsequent to the date of the S corporation termination.

Had the Company operated as a C corporation for all of 1993, the net income tax benefit of the Company's $519,779 net loss would be approximately $176,700 at the federal statutory rates. The actual benefit differs because the Company is required by the Internal Revenue Code to allocate its income between the S corporation and C corporation periods of the year. The C corporation net operating loss (NOL) for tax purposes at December 31, 1992 (the Company files its tax return on a calendar year basis) was $171,989. The majority of this NOL was utilized in eliminating the Company's income tax expense for the year ended April 4, 1993.

Had the Company operated as a C corporation from inception, the Company would have recorded a pro forma income tax expense of approximately $23,000 and $5,000 for the years 1991 and 1992, respectively. In 1993, pro forma income tax expense from prior periods totaling $29,000 would have been recognized as an income tax benefit based on net operating loss carryback rules.

Deferred income taxes are due to temporary differences between the carrying values of certain assets and liabilities for financial reporting and income tax purposes. Significant components of deferred taxes at April 4, 1993 are as follows:

Deferred assets:	
Deferred revenue	$54,400
Accrued rent	99,300
Allowance for doubtful accounts	5,000
Inventory reserve	14,800
	173,500
Deferred liabilities:	
Prepaid commissions	14,100
Prepaid advertising	36,800
	50,900
Net deferred tax assets before valuation allowance	122,600
Valuation allowance for net deferred tax assets	(122,600)
Net deferred taxes	$ –

8. Subsequent Events

Through May 28, 1993, the Company has commenced, subsequent to April 4, 1993, retail operations at seven additional FuncoLand stores bringing the total number of operating stores to 63. The future minimum lease payments under non-cancelable operating leases as disclosed in Note 4 include the commitments for these seven locations as well as three locations to be opened subsequent to May 28, 1993 for which lease agreements have been signed.

In April 1993, the Company commenced activity to undertake a public offering of the Company's common stock. The Company intends to sell approximately 1,250,000 shares.

Subsequent to year end, the Company entered into a series of sale/leaseback transactions with a leasing company for which a Director of the Company serves as Chairman of the Board. As of May 28, 1993, the Company has sold and leased back equipment with the leasing company totaling approximately $490,000.

In May 1993, the Board of Directors, subject to approval by shareholders at the 1993 annual meeting, terminated the 1992 Employee Incentive Stock Option Plan and adopted the 1993 Stock Option Plan (the "1993 Plan"). The 1993 Plan initially reserves 348,750 shares, equal to the ungranted portion of the terminated plan. Options available under this plan will increase annually based upon shares of the Company's common stock outstanding. The 1993 Plan authorizes the granting of both Incentive Stock Options and non-qualified options. Upon adoption of the 1993 Plan by the Board of Directors, options were granted for the purchase of 131,000 shares. Such options are to become effective the day following the date of the Prospectus related to the proposed public offering of the Company's common stock, at an exercise price equal to the offering price thereof. The options become exercisable on and after the date of grant and expire on the tenth anniversary of the date of the grant. In the event the shareholders do not approve adoption of the 1993 Plan, such options will be nullified.

SHAREHOLDER INFORMATION

BOARD OF DIRECTORS

David R. Pomije
Chairman of the Board, President and Chief Executive Officer

Stanley A. Bodine
Executive Vice President

Mallard W. Benton
Group Vice President
Live Entertainment, Inc.

Donald R. Brattain
President
Brattain and Associates, Inc.

Richard T. Guidera
President
The Guidera Group, Inc.

CORPORATE OFFICERS

David R. Pomije
Chairman of the Board, President and Chief Executive Officer

Stanley A. Bodine
Executive Vice President

Jeffrey R. Gatesmith
Vice President of Retail Operations and Human Resources

Robert M. Hiben
Controller

Michael B. Hinnenkamp
Vice President of Information Systems and Merchandising

ANNUAL MEETING

The annual shareholders' meeting will be held on Tuesday, August 17, 1993 at 4:00 p.m. at the Minneapolis Marriot Southwest in Minnetonka, Minnesota.

CORPORATE ADDRESS

Funco, Inc.
10120 West 76th Street
Minneapolis, Minnesota 55344
612-946-8883

CORPORATE COUNSEL

O'Connor & Hannan
Minneapolis, Minnesota

INDEPENDENT AUDITORS

Ernst & Young
Minneapolis, Minnesota

TRANSFER AGENT

Norwest Bank Minnesota, N.A.
South St. Paul, Minnesota

COMMON STOCK

The Company's common stock was first traded publicly on August 12, 1992. The stock is listed on the NASDAQ under the symbol "FNCO". The table below sets forth the high and low bid prices of the Company's common stock as reported by NASDAQ for the periods indicated:

	1993 Fiscal Quarter	
	High	Low
Second	$5 ½	$5
Third	9 ½	5 ½
Fourth	17 ¼	9

At June 23, 1993 there were 5,678,304 shares of common stock outstanding, held by 185 shareholders of record. The Company has not paid any cash dividends on its common stock and does not anticipate paying cash dividends in the foreseeable future. Under the Company's current bank credit agreement, the Company is prohibited from paying dividends without the bank's prior written consent.

10-KSB REPORT

Shareholders who wish to obtain a copy of our annual report 10-KSB filed with the Securities and Exchange Commission for the fiscal year ended April 4, 1993, may do so by writing Investor Relations at the Corporate Address.

FuncoLand

Funco, Inc. 10120 West 76th Street
Minneapolis, Minnesota 55344